



# **COMPLIANCE AND CONTROL AUDIT REPORT**

**Kansas Correctional Industries**

**A Report to the Legislative Post Audit Committee  
By the Legislative Division of Post Audit  
State of Kansas  
June 2003**

# ***Legislative Post Audit Committee***

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## ***Legislative Division of Post Audit***

**The Legislative Post** Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about \$9 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of government agencies. The audit work performed by Legislative Post Audit helps provide that information.

We conduct our audit work in accordance with applicable government auditing standards set forth by the U. S. General Accounting Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. These audit standards have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

The Legislative Post Audit Committee is a bipartisan committee comprising five senators and five representatives. Of the Senate members, three are appointed by the President of the Senate and two are appointed by the Senate Minority Leader. Of the representatives, three are appointed by the Speaker of the House and two are appointed by the House Minority Leader.

As part of its audit responsibilities, the Division is charged with meeting the requirements of the Legislative Post Audit Act which address audits of financial matters. Those requirements call for two major types of audit work.

First, the Act requires an annual audit of the State's financial statements. Those statements, prepared by the Department of Administration's Division of Accounts and Reports, are audited by a certified public accounting firm under contract with the Legislative Division of Post Audit. The firm is selected by the Contract Audit Committee, which comprises three members of the Legislative Post Audit Committee (including the Chairman and Vice-

Chairman), the Secretary of Administration, and the Legislative Post Auditor. This audit work also meets the State's audit responsibilities under the federal Single Audit Act.

Second, the Act provides for a regular audit presence in every State agency by requiring that audit work be conducted at each agency at least once every three years. Audit work done in addition to the annual financial statement audit focuses on compliance with legal and procedural requirements and on the adequacy of the audited agency's internal control procedures. These compliance and control audits are conducted by the Division's staff under the direction of the Legislative Post Audit Committee.

### **LEGISLATIVE POST AUDIT COMMITTEE**

Representative John Edmonds, Chair  
Representative Tom Burroughs  
Representative Bill McCreary  
Representative Frank Miller  
Representative Dan Thimesch

Senator Derek Schmidt, Vice-Chair  
Senator Bill Bunten  
Senator Anthony Hensley  
Senator Dave Kerr  
Senator Chris Steineger

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Barbara J. Hinton, Legislative Post Auditor

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LEGISLATURE OF KANSAS  
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June 11, 2003

To: Members, Legislative Post Audit Committee

Representative John Edmonds, Chair	Senator Derek Schmidt, Vice-Chair
Representative Tom Burroughs	Senator Bill Bunten
Representative Bill McCreary	Senator Anthony Hensley
Representative Frank Miller	Senator Dave Kerr
Representative Dan Thimesch	Senator Chris Steineger

This report contains the findings and recommendation from our completed compliance and control audit of *Kansas Correctional Industries*.

The report includes one recommendation for the agency. We would be happy to discuss the recommendation or any other items in the report with any legislative committee, individual legislators, or other State officials.

A handwritten signature in black ink, reading "Barbara J. Hinton". The signature is written in a cursive, flowing style. The first name "Barbara" is written in a larger, more prominent script, and "J. Hinton" follows in a similar but slightly smaller script.

Barbara J. Hinton  
Legislative Post Auditor



# EXECUTIVE SUMMARY

LEGISLATIVE DIVISION OF POST AUDIT

## ***Does Kansas Correctional Industries Have Adequate Business Procedures To Ensure That Its Revenues, Expenditures, and Inventory Are Handled Appropriately?***

**Correctional Industries has established adequate financial-management practices to ensure that it collects and deposits the appropriate amounts of revenue from the sale of prison-made goods.** ..... page 3  
*Most of the agency's revenues come from the sale of prison-made goods—about \$8.4 million during fiscal year 2002. We found that the agency had reasonable practices in place to collect and deposit these revenues. We also tested a sample of revenue transactions and found that proper amounts were, in fact, collected and appropriately deposited. The agency overcharged by a small amount one of the private businesses leasing space in a correctional facility. The agency indicated that the overcharge has since been corrected.*

**Correctional Industries has established adequate financial-management practices to ensure that it handles its expenditures appropriately.** ..... page 4  
*We found that the agency's expenditure practices were reasonable. We also tested a sample of expenditure transactions and found that they were properly recorded and made for allowable purposes.*

**Correctional Industries generally has established adequate financial-management practices to ensure that it handles its inventory appropriately.** ..... page 4  
*The agency restricts access to its inventory, and issues inventory only for authorized and approved transactions. We also test-counted a sample of inventory items and found no significant discrepancies. Correctional Industries is working toward having more of the inventory items recorded in its automated inventory system. That action should further improve controls over inventory.*

**Recommendation** ..... page 5

**Appendix A: Agency Response** ..... page 6

This audit was conducted by Randy Tongier, Audit Manager. If you need any additional information about the audit's findings, please contact Mr. Tongier at the Division's offices. Our address is: Legislative Division of Post Audit, 800 SW Jackson Street, Suite 1200, Topeka, Kansas 66612. You also may call us at (785) 296-3792, or contact us via the Internet at [LPA@lpa.state.ks.us](mailto:LPA@lpa.state.ks.us).



# Kansas Correctional Industries

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The Legislative Division of Post Audit has conducted compliance and control audit work at Kansas Correctional Industries. Compliance and control audits can identify noncompliance with applicable requirements and poor financial-management practices. The resulting audit findings often identify needed improvements that can help minimize the risk of potential future loss or misuse of State resources.

At the direction of the Legislative Post Audit Committee, this audit focused on Correctional Industries' basic business practices. The audit addresses the following specific question:

**Does Kansas Correctional Industries have adequate business procedures to ensure that its revenues, expenditures, and inventory are handled appropriately?**

To answer this question, we reviewed applicable statutes and standard financial-management practices. We also interviewed appropriate staff members of Correctional Industries, and reviewed the facility's files and records. Our audit did not include the federal and State surplus property operations. This audit work covers fiscal year 2002.

In conducting this audit, we followed all applicable government auditing standards.

## Kansas Correctional Industries AT A GLANCE

**Authority:** Created by K.S.A. 75-5273.

**Staffing:** Correctional Industries is authorized 76.0 full-time-equivalent positions.

**Budget:** Correctional Industries' major funding comes from revenues generated by the sale of prison-made goods. For fiscal year 2002, the Authority took in and spent about \$10.7 million as shown below. Most of these moneys were payments for purchase of materials and other operating costs.

FY 2002 Expenditures			Sources for Funding for Expenditures	
<u>Type</u>	<u>Amount</u>	<u>% of Total</u>		
Commodities	\$4,935,969	46%	Correctional Industries Fund	\$10,737,467
Salaries & Wages	\$3,076,292	29%	(mainly from the sale of prison-made goods)	
Contractual Services	\$1,720,167	16%		
Capital Outlay and Improvements	\$927,167	9%		
Other	\$77,872	1%		
<b>Total Expenses:</b>	<b>\$10,737,467</b>	<b>100%</b>	<b>Total Funding:</b>	<b>\$10,737,467</b>

Source: *The Governor's Budget Report*, Vol. 2, FY 2004.



## Does Kansas Correctional Industries Have Adequate Business Procedures To Ensure That Its Revenues, Expenditures, and Inventory Are Handled Appropriately?

Correctional Industries' procedures for handling revenues, expenditures, and inventory generally are well-designed and were operating effectively during the period we reviewed. One private industry leasing space at one of the correctional facilities was overcharged a small amount on its lease. In addition, Correctional Industries continuing efforts to increase the amount of inventory covered by its automated inventory system should improve inventory controls. The basis for our conclusion is presented below.

### *Correctional Industries Has Established Adequate Financial-Management Practices To Ensure That It Collects and Deposits The Appropriate Amounts Of Revenue From the Sale of Prison-Made Goods*

State law allows the sale of prison-made goods to State agencies, the federal government, local agencies, churches and other not-for-profit organizations within the State, and other states. Correctional Industries has four major sources of revenues—sales of prison-made goods in what are called traditional industries (such as the sign and paint factories), lease revenues from private industries operating within the correctional facilities, sales of federal surplus property, and sales of State surplus property. According to agency accounting reports, fiscal year 2002 revenues from these sources were the following:

Source	Revenues	Percentage of Total
Traditional Industries	\$ 8,408,779	74 %
Private Industries	1,435,292	13
Federal Surplus Property	962,876	8
State Surplus Property	627,696	5
TOTAL	\$ 11,434,643	100

Source: Accounting Reports of Kansas Correctional Industries

Correctional Industries is responsible for developing and implementing procedures to ensure that it collects and deposits the appropriate amounts of revenues. In addition, the agency is responsible for adhering to statutory limitations on its types of customers. Allowed customers include State agencies, the federal government, local agencies, churches and other not-for-profit organizations within the State, and other states. Basic procedures that would help accomplish this goal include:

- Selling only to allowable types of customers
- Billing customers for items that are shipped
- Collecting amounts that are billed
- Depositing amounts that are collected in the State Treasury
- Keep complete and accurate records of amounts due, collected, and deposited

To identify and evaluate the procedures used by Correctional Industries, we interviewed officials, reviewed applicable accounting records and files, and tested samples of sales transactions. Correctional Industries had appropriate practices in place, and appropriate amounts were collected and deposited.

One private industry leasing space at the Hutchinson Correctional Facility was overcharged a small amount on its lease. According to the lease agreement, that company should have paid \$3,338 per month. However, the company was billed and paid \$3,380—an overcharge of \$42. Over the course of a year, the total amount overpaid amounted to about \$500. When we brought this to the attention of agency staff, they told us they would correct the problem and reimburse the company for the overcharge.

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***Correctional Industries Has Established Adequate Financial-Management Practices To Ensure That It Handles Its Expenditures Appropriately***

State law (K.S.A. 75-5282) limits the use of Correctional Industries' moneys to the purchase of manufacturing supplies and equipment, repair and maintenance, administrative expenses, and capital acquisitions and improvements. Further, the agency is responsible for establishing appropriate fiscal controls over the expenditure of its moneys. Basic procedures that would help accomplish this goal include:

- Authorizing and approving purchases and other expenditures
- Requiring receipt of goods or services before payment is made
- Independently reviewing supporting documents before payment is made

To identify and evaluate the procedures used by Correctional Industries, we interviewed officials, reviewed applicable accounting records and files, and tested samples of expenditure transactions. Correctional Industries had appropriate practices in place, and expenditures were for appropriate and allowable purposes.

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***Correctional Industries Generally Has Established Adequate Financial-Management Practices To Ensure That It Handles Its Inventory Appropriately***

As with any manufacturing operation, Correctional Industries has a sizeable investment in inventory. According to agency accounting reports, the ending inventory cost for fiscal year 2002 was about \$2.3 million. This included both raw materials not yet put into production and finished goods ready for shipment. The agency is responsible for ensuring proper use of inventory and limiting the risk of loss or misuse. Basic procedures that would help accomplish this goal include:

- Ensuring that all items purchased and received are put into inventory

- Restricting access to inventory items—both raw materials and finished goods
- Shipping items only for authorized sales
- Taking a periodic physical inventory and updating accounting records accordingly
- Reviewing differences between recorded and actual inventory counts

To identify and evaluate the procedures used by Correctional Industries, we interviewed appropriate officials, reviewed applicable accounting records and files, and performed physical counts of a sample of inventory items. Correctional Industries generally had appropriate practices in place, and any differences between recorded and actual counts were minor.

**Correctional Industries is working toward having more of the inventory recorded in its automated inventory system.** The agency has an automated cost accounting system (Job-Tech), which includes an inventory component that's capable of updating inventory amounts on an ongoing basis—with the purchase, use, and sale of these items recorded as they occur. For those items, the inventory records will show the actual amount of inventory that should be on hand at any given time. When that is the case, periodic physical counts can serve as both as a check on possible loss of those items and as a check on the accuracy of the recorded amounts. The system also is capable of providing summary statistics on differences between actual and recorded counts when the physical inventory is done. Such a system can be a powerful control tool for management of inventory.

However, not all inventory items are currently on the automated system. For items not on the system, the recorded amount of inventory is simply the amount from the last physical count. There's no indication of how much inventory should be present. As a result, those inventory items are less well controlled, and are more subject to the risk of loss or misappropriation. In addition, the system's management usefulness is limited. Correctional Industries officials say they plan to increase the number of inventory items on the automated system. This step would further improve the agency's inventory controls.

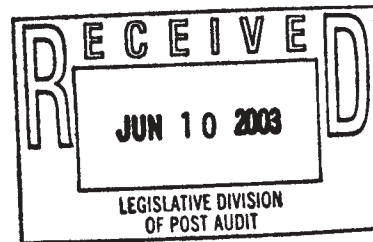
<b>Recommendation</b>	To further limit the risk of loss or misappropriation of inventory, Correctional Industries should continue its efforts to add more inventory items to its automated inventory system.
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## **APPENDIX A**

### **Agency Response**

On May 28, 2003, we provided copies of the draft audit report to Kansas Correctional Industries. The agency's response is included as this Appendix.

# KANSAS



KANSAS CORRECTIONAL INDUSTRIES  
RODNEY CRAWFORD, DIRECTOR

KATHLEEN SEBELIUS, GOVERNOR

May 29, 2003

Barbara J. Hinton, Legislative Post Auditor  
Legislative Division of Post Audit  
800 Southwest Jackson Street, Suite 1200  
Topeka, KS 66612-2212

Dear Ms. Hinton,

We would like to thank you for the opportunity you have provided KCI to comment on the draft audit report on Kansas Correctional Industries Business Procedures. Also, we would like to take this opportunity to compliment Mr. Randy Tongier for his thorough and professional job.

While we agree with the facts as presented and with the conclusions drawn, we also believe the audit recommendation merits further clarification by Kansas Correctional Industries.

"Audit Recommendation: To further limit the risk of loss or misappropriation of inventory, Correctional Industries should continue its effort to add more inventory items to its automated inventory system."

KCI's staff and management remains committed to the inventory control process, in July the last Lansing division, Wood Furniture Division, will be fully integrated into the system. Plans are currently in development to add the final two divisions, at the Hutchinson Correctional Facility into the inventory control system. These divisions will be added as time and resources permit.

Once again, thank you for allowing us the opportunity to share our thoughts and comments on the draft report as submitted.

Sincerely,

A handwritten signature in dark ink, appearing to read "Rodney Crawford", written over a horizontal line.

Rodney Crawford, Director  
Kansas Correctional Industries

RC/ech

cc: Roger Werholtz, Secretary of Corrections  
Roger Haden, Deputy Secretary of Corrections  
Teresa Lee, KCI Business Manager  
File

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